Washington Utilities and Transportation Commission (WUTC)
Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, to Encourage Utilities to Meet or Exceed Their Conservation Targets

In April 2010, the WUTC announced it would examine the effects of conservation on the revenues of natural gas and electric utilities. The issue arose in the 2010 legislative session when some utilities asserted that state policies designed to promote energy conservation lower the opportunity to make a profit because a utility's revenues are directly related to the volume of energy sold.

As part of the inquiry, the WUTC solicited written comments and held two work sessions between May and June 2010. The WUTC issued a report and policy statement in November 2010 that examined three issues: (1) decoupling; (2) recovery of "lost margin" due to conservation; and (3) utility incentives for conservation. A policy statement is an advisory statement of the agency's current opinion, approach, and likely course of action.

Decoupling and Lost Margin. Generally, a natural gas or electric utility is allowed to charge a rate sufficient to provide it an opportunity to recover its fixed costs (e.g., interest on debt, employee payroll, and maintenance costs) and earn a profit margin based on forecasted sales. Assuming all things are equal, if actual sales are the same as those used to set rates, the utility can recover its costs and earn its profit margin. If actual sales exceed the sales used to set rates (e.g., additional use by customers or new customers), the utility can earn extra profit, sometimes called "found margin." But if actual sales fall below the sales used to set rates (e.g., due to conservation by customers, weather, or an economic downturn), the utility may earn less profit and may not be able to recover all of its costs. This is sometimes called "lost margin," and some assert that it is a disincentive for utilities to promote conservation. Their solution is to separate or "decouple" a utility's recovery of its fixed costs from the amount of energy it sells and allow, between rate cases, a rate adjustment that would "true-up" the utility's revenues to ensure either recovery of the utility costs, or in some forms of decoupling, a refund to ratepayers of excess revenues.

"Limited decoupling" means a utility may recover lost margin resulting from specified causes, such as conservation efforts by the utility. "Full decoupling" allows recovery for lost margin under all circumstances, including weather fluctuations and efficiency gains as well as an economic downturn. Over the past five years the WUTC has examined decoupling in various forms, approving two specific limited decoupling pilots for natural gas utilities to examine the actual operation of the mechanism. In December 2009, the WUTC approved a permanent limited decoupling for Avista's gas utility designed to allow the utility to recover its lost margin caused by its conservation programs.

Limited Decoupling for Natural Gas. Because the consumption of natural gas has been declining in recent years, the WUTC has approved limited decoupling for natural gas utilities on a case-by-case basis and will continue do so according to the policy statement. The WUTC states that, "In the context of a general rate case, the Commission will consider a limited decoupling mechanism for natural gas utilities . . . conditioned upon a utility's level of achievement with respect to its conservation target." The policy statement specifies the minimum elements a utility must

include in its request for limited decoupling, such as evaluation of the risk to investors and ratepayers.

No Limited Decoupling for Electric Utilities. The policy statement declares that the WUTC does not favor limited decoupling for electric utilities because limited decoupling would not capture potential offsetting effects in the electric industry. The report explains that because electricity use has been steady or increasing in recent years, there is less potential risk that conservation efforts will adversely affect utility revenues. In addition, the policy statement notes that electricity saved by conservation can be sold to others or used to replace short-term energy purchases that would otherwise have been made. Finally, the policy statement notes that there is less of a need to provide an incentive to electric utilities given the mandatory conservation requirements in the Energy Independence Act (I-937) provide "ample incentive" for electric utilities to obtain all cost-effective conservation.

Full Decoupling for Electric and Natural Gas Utilities. The WUTC policy statement notes that few states have adopted full decoupling for electric utilities, which means fewer lessons have been learned on how the mechanism actually works. The report also expresses a concern that under full decoupling, an electric utility "could lose some of its incentive to manage the company in a manner that constantly looks to reduce costs." Nevertheless, the WUTC will consider, "[i]n the context of a general rate case, . . . a full decoupling mechanism for electric and natural gas utilities, which will allow a utility to either recover revenue declines related to reduced sales volumes or, in the case of sales volume increases, refund such revenues to its customers." Unlike limited decoupling, the revenue or refund "true-up" is not limited to lost revenue due to conservation. Variations in revenue caused by economic downturn, weather, or any other reason would be included in the true-up mechanism. The policy statement specifies the minimum elements a utility must include in its request for full decoupling, such as evaluation of the risk to investors and ratepayers.

Conservation Incentives. The WUTC has statutory authority to approve direct conservation incentives for both electric and natural gas utilities. And as the report notes, the WUTC has previously approved a direct bonus for one large electric utility for exceeding pre-established conservation targets.

In addition to the WUTC's authority to promote conservation, I-937 provides penalties for electric utilities that do not achieve their biennial conservation targets that are set to ensure the utilities acquire all cost-effective conservation. I-937 also allows the WUTC to consider incentives for investor-owned utilities to exceed the conservation targets. The WUTC does not believe this authority allows incentives for conservation that is *not cost-effective*. Rather, the WUTC's policy statement explains this authority refers to conservation efforts that become cost-effective because of improved technology, the availability of federal or other matching funds, or for other reasons that were not known at the time of the setting of the targets. Accordingly, the policy statement declares that in addition to decoupling measures to recover lost margins, the WUTC will consider mechanisms under I-937 that will provide electric utilities' incentives to exceed their I-937 conservation targets. The WUTC will also consider similar mechanisms for natural gas utilities. The policy statement specifies the minimum elements a utility must include in its request for a conservation incentive, such as evidence that the mechanism is cost-effective.